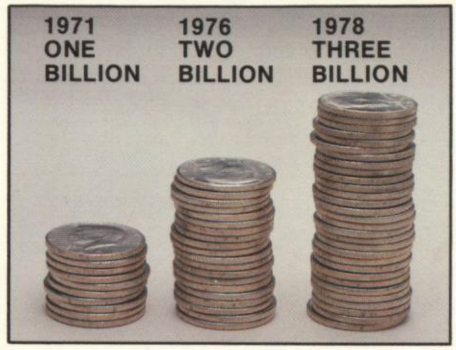
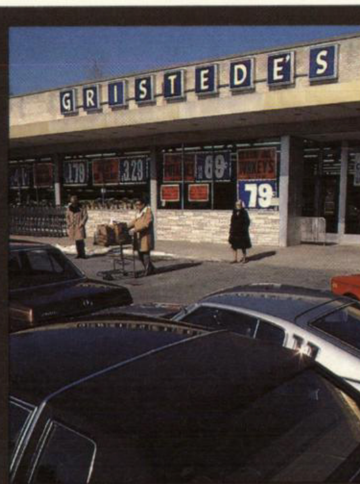
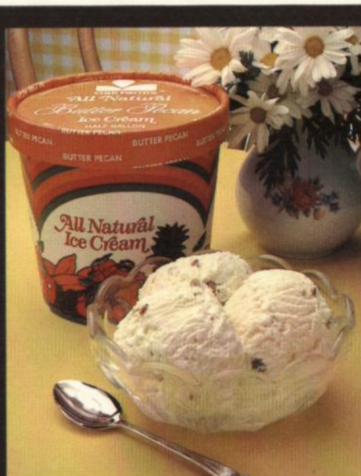


THE SOUTHLAND CORPORATION 1978 ANNUAL REPORT

STORES GROUP



DAIRIES GROUP



SPECIAL OPERATIONS GROUP

THE SOUTHLAND CORPORATION

AUSTRALIA
CANADA
JAPAN
MEXICO
UNITED KINGDOM
UNITED STATES

R S McColl Limited

Charles & Co.

SOUTHLAND FOOD CENTERS

Landshire Sandwiches

GRISTEDE'S

southland distribution center

ADOHR FARMS
BANCROFT DAIRY
BRIGGS DAIRY
CABELL'S
EMBASSY DAIRY
HARBISONS DAIRIES
HORTEN'S DAIRY
MIDWEST FARMS
OAK FARMS
VELDA FARMS
WANZER'S

CHEMICAL

Hudgins Truck Rental

Reddy Ice

TIDEL SYSTEMS

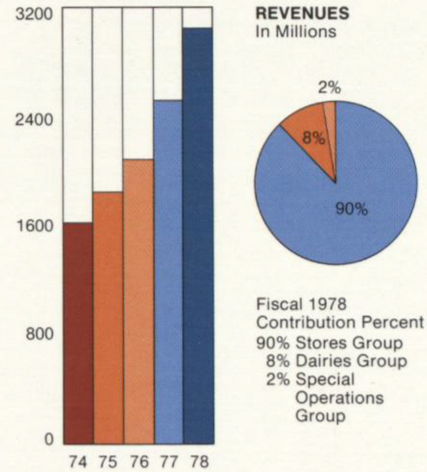
CHIEF AUTO PARTS

THE SOUTHLAND CORPORATION, originator of the convenience store concept and one of the nation's major retailers, groups its operations for reporting purposes into three business segments.

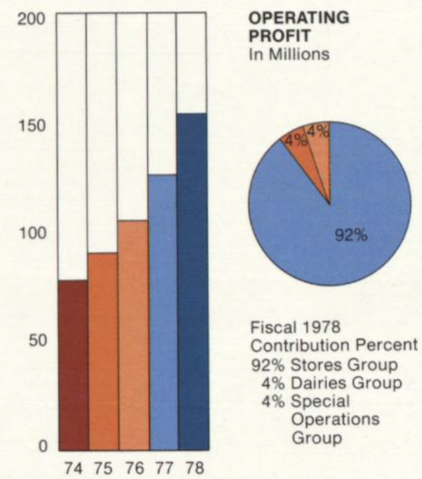
The Stores Group is the world's largest operator and franchisor of convenience stores with 6,599 **7-ELEVEN** stores in 42 states, the District of Columbia, and five provinces of Canada. Three Distribution Centers serve 3,916 **7-ELEVEN** stores with approximately 50% of their merchandise needs. Food Centers, located at each Distribution Center, prepare a variety of sandwiches for distribution to **7-ELEVEN** and other customers. Other retail operations include 109 Gristede's and Charles & Co. food stores and sandwich shops in metropolitan New York, 383 R S McColl confectionery, tobacco, and news stores, and seven **7-ELEVEN** units in the United Kingdom. Southland also has an equity interest in five Super Siete stores in Mexico and 23 Näröppet stores in Sweden. An additional 279 **7-ELEVEN** stores are operated by area licensees in the United States, 559 in Japan, five in Canada, and 12 in Australia.

The Dairies Group is a major processor of dairy products, which are distributed under 11 well-known regional brand names in 34 states and the District of Columbia.

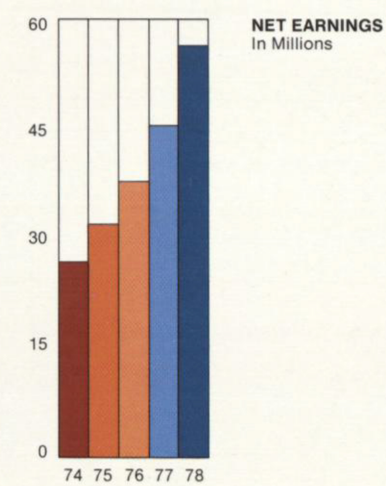
The Special Operations Group includes the Chemical, Reddy Ice, Hudgins Truck Rental, and Tidel Systems Divisions. In addition, Chief Auto Parts, a retail automobile supply chain of 119 stores in southern California, was acquired at year-end.



Fiscal 1978
Contribution Percent
90% Stores Group
8% Dairies Group
2% Special Operations Group



Fiscal 1978
Contribution Percent
92% Stores Group
4% Dairies Group
4% Special Operations Group



TO OUR SHAREHOLDERS:

Southland began its second half-century with the greatest year in its history as new records were established in both sales and earnings.

Led by the outstanding performance of 7-Eleven, revenues reached a new high of $3.090 billion, up 21.4% from $2.545 billion a year ago. Net earnings were a record $57.1 million, 26.0% greater than 1977 earnings of $45.3 million. Primary earnings per share rose 25.2% to $2.83, while diluted earnings increased 25.1% to $2.74.

The Company's excellent growth trend continues to reflect increasing consumer acceptance of convenience shopping. 7-Eleven sales advanced almost one-half billion dollars, climbing to $2.595 billion, up 23.5%. Contributing to the consistent gains throughout the year were the success of Southland's first schedule of prime-time network television advertising, aggressive in-store merchandising and promotional programs, new store openings, and a 70% increase in self-serve gasoline sales.

Operating profits of the Dairies Group, Southland's second largest business segment, improved substantially after a slow first quarter. Market price adjustments in many areas, as well as continuing programs to increase processing efficiency and control operating costs, contributed to the excellent gains.

The Company's three regional Distribution Centers, which supply 59% of the 7-Eleven stores, made a significant contribution to profits, with sales up 17.7%. The Special Operations Group, which includes the Hudgins Truck Rental, Chemical, Reddy Ice, and Tidel Divisions, achieved a 17.4% sales gain.

Construction of 7-Eleven stores was delayed during the first quarter by severe winter weather, but by year-end 550 had been added. A total of 308

Financial Highlights
(Dollars in thousands except per share data)

	Year Ended December 31		
For the Year	**1978**	1977	% Change
Total Revenues	**$3,090,094**	$2,545,415	21.4
Net Earnings	**57,097**	45,317	26.0
Primary Earnings Per Share*	**2.83**	2.26	25.2
Diluted Earnings Per Share	**2.74**	2.19	25.1
Cash Dividends	**13,627**	10,961	24.3
Return on Beginning Shareholders' Equity	**17.3%**	15.6%	
At Year-End			
Working Capital	**141,633**	136,693	3.6
Current Ratio	**1.54**	1.66	
Long-Term Debt	**261,460**	195,520	33.7
Shareholders' Equity	**374,467**	329,952	13.5
Book Value Per Share*	**18.55**	16.48	12.6
Annual Dividend Rate Per Share	**.72**	.60	20.0
Average Shares Outstanding (000's)	**20,182**	20,016	.8
Number of Shareholders	**8,627**	8,764	(1.6)
Number of Employees	**37,000**	34,000	8.8

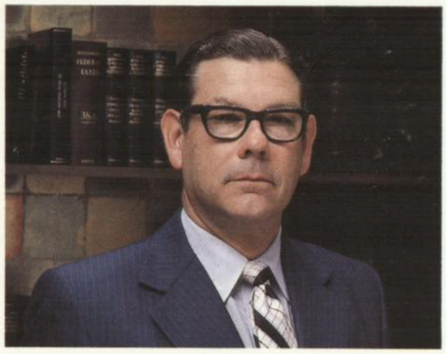
*Based on average number of shares outstanding during the period after adjusting for all stock dividends.

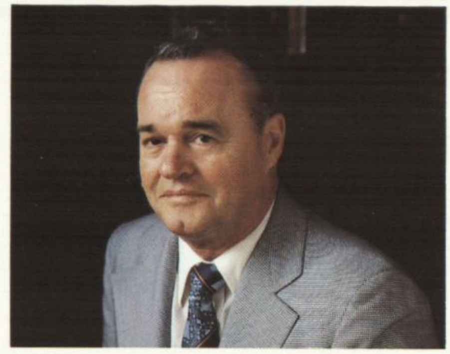
John P. Thompson (far left),
Chairman and Chief Executive Officer

Jere W. Thompson, President

Walton Grayson, III,
Executive Vice President,
Administration and Services

Joseph S. Hardin,
Executive Vice President,
Planning and Special Operations





stores were closed as a result of lease expirations, changing traffic patterns, re-locations to newly available and more desirable sites, or unsatisfactory performance. At December 31, there were 6,599 convenience stores in operation in 42 states.

In addition, both domestic and international area licensees continued to exceed their expansion goals with a total of 855 7-Eleven stores open at year-end. During the year, 40 units were opened in the United States, 211 in Japan, nine in Australia, and five in eastern Canada where a licensing agreement was signed early in 1978. We believe the 7-Eleven area licensing concept is adaptable to many other countries and will continue to provide Southland with additional avenues of growth.

Self-serve gasoline continues to achieve remarkable acceptance by the American public. Now representing 13.4% of Southland's convenience store sales, compared with 9.8% last year, self-serve gasoline is available at more than one-fourth of the 7-Eleven stores. Obviously, the continuing instability of world oil supplies may affect all gasoline retailers. However, based upon our past experience, and in view of the current stand-by allocation regulations, we do not anticipate any material effect on the Company's operations.

Your Company expanded into a new line of business in December, 1978, with the acquisition of Chief Auto Parts, a chain of 119 retail automobile supply stores in southern California. Chief, founded in 1966, has an excellent growth record and provides an opportunity to adapt our convenience store expertise to another field of retailing, one which serves primarily the do-it-yourselfer from small, convenient, neighborhood locations.

Our confidence in the potential growth of the convenience store business is backed by our commitment to invest substantial amounts of both earnings and external funds to maintain our position of leadership in the fastest growing segment of the retail food industry. Capital expenditures in 1978 were $152.4 million, 73% or $110.5 million of which was for the Stores Group, 6% for the Dairies Group, 15% for the Special Operations Group, and 6% for Corporate.

"As we . . . reflect proudly on Southland's fifty years of growth under a variety of economic conditions and social changes, we look forward to the achievement of a new goal — three billion dollars in annual revenues."
1976 ANNUAL REPORT

Although our long-term objective is to finance expansion from retained earnings, other methods of raising funds are used when necessary to attain our goals. In late 1978, the Company offered $50 million of unsecured 9⅜% Sinking Fund Debentures, due December 15, 2003. These debentures, as well as a 1977 8⅜% issue, are rated "A" by both Moody's and Standard & Poor's and listed on the New York Stock Exchange.

In April, the annual cash dividend rate was increased 20% to 72 cents a share. Cash dividends have been paid each year since 1957, and the annual rate has been raised seven times in the past eight years, providing shareholders an average compound growth rate of 20.7%. In addition, for the 13th consecutive year a 3% stock dividend was distributed.

We are delighted that 12% of our shareholders are participating in the Automatic Stock Purchase Plan, which was transferred in January, 1979, to The First National Bank in Dallas. The program provides a cost-free method for shareholders to automatically reinvest cash dividends and now also allows participants to invest as much as an additional $5,000 each quarter in the Company's shares.

Southland, a concerned corporate citizen of the many communities in which we operate, supports numerous community projects. For the third year, the Company received nationwide recognition as the largest fund raiser for the Muscular Dystrophy Association through the Jerry Lewis Labor Day Telethon. Successful campaigns conducted by employees, franchisees, suppliers, and customers resulted in the collection last year of $4.2 million for "Jerry's Kids." In addition, the Dairies Group recently became the first national corporate sponsor of the March of Dimes and assisted that organization to increase public awareness of, and recruit volunteers for, the Mother's March Against Birth Defects held in late January, 1979.

Your Company's outstanding performance attests to the continuing dedication, loyalty, and talent of the "Southland family." We are confident that the Company has the human and financial resources to meet the challenges of a rapidly changing business environment, and look forward to another year of excellent growth in 1979.

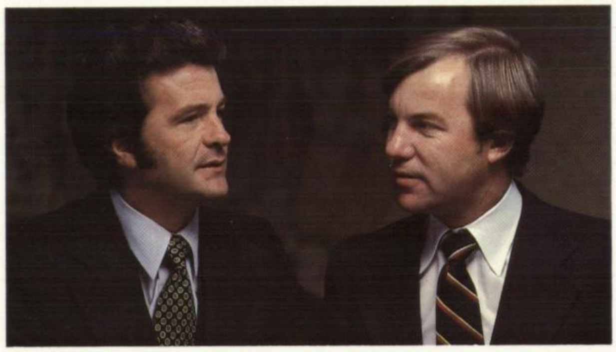
John P. Thompson

JOHN P. THOMPSON
Chairman

Jere W. Thompson

JERE W. THOMPSON
President

March 7, 1979



S. R. "Dick" Dole (left) and Ray D. Berry, Vice Presidents, Stores Group, joined Southland in 1964.

STORES GROUP

Stores Group sales increased $516 million to $2.784 billion, up 22.8% from $2.268 billion in 1977, and represented 90% of total Company sales. For the year, **7-ELEVEN** sales alone were $2.595 billion, a gain of 23.5% from the prior year's $2.1 billion.

The outstanding performance by the convenience stores was due to enthusiastic customer response to prime-time network advertising, aggressive in-store merchandising and promotional programs, competitive pricing of selected items, and higher self-serve gasoline demand, as well as the addition of new stores.

At year-end, there were 6,599 **7-ELEVEN** stores, 4,056 Company operated and 2,543 franchised, in 42 states, the District of Columbia, and five provinces of Canada. During the year, 550 stores were opened, including units in two additional states, Hawaii and Montana. Because of population shifts, changes in traffic patterns, lease expirations, and relocations to newly available and more desirable sites, 308 stores were closed. Approximately 91% of all stores are open beyond the traditional 7 a.m. to 11 p.m., including 5,407 which are open around the clock.

7-ELEVEN Customers

Convenience — giving customers what they want, when they want it, where they want it — is the reason approximately 5.4 million customers choose to shop **7-ELEVEN** each day. The easily accessible neighborhood locations and quick, friendly service are widely recognized and appreciated, but customers also choose **7-ELEVEN** for its popular fast foods selections, self-serve gasoline, and extended hours of operation at most stores.

Our Customers

69.8% male
80.2% in 18-49 age group
80.9% live/work in area
4.3 average trips a week
30.1% shop on weekends
50.2% shop 1 p.m. to 10 p.m.
$1.54 average purchase
822 customers daily per store

Customer statistics are based upon a study conducted in 1978, by Southland's Market Research Department, of a geographically dispersed random sampling of **7-ELEVEN** stores. Population statistics are from reports of the U.S. Department of Commerce, Bureau of the Census.

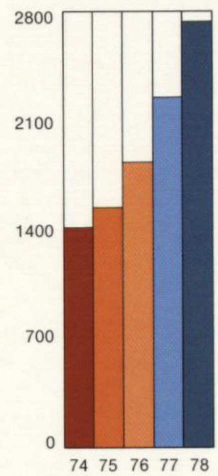
Self-Serve Gasoline

Self-serve gasoline has experienced phenomenal acceptance by the American public and now accounts for approximately 60% of all gasoline sales, according to industry sources. In response to this demand, **7-ELEVEN** now provides self-serve gasoline at 1,857 locations. A substantial increase in volume at existing units, as well as the addition of gasoline at 284 stores, resulted in a 70% sales increase for the year. In addition, the availability of gasoline generates related sales, as more than 30% of these customers purchase other merchandise.

City Stores

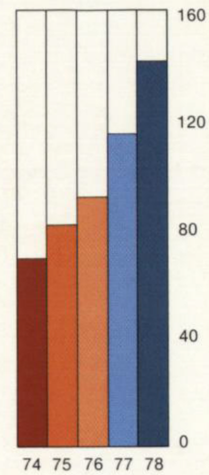
An exciting concept still in the test stage, "City Stores" creates new opportunities to expand **7-ELEVEN** in many markets. Located in high-density metropolitan residential areas, the stores fill a genuine need for their walk-in customers. Early in the year, stores were opened in Boston and San Francisco, and in September the first **7-ELEVEN** was opened in New York City at 34th Street and Lexington Avenue. Initial customer acceptance has been excellent.

STORES GROUP SALES
In Millions

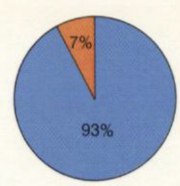


Compound Growth Rate: 18.0%

STORES GROUP OPERATING PROFIT
In Millions



Compound Growth Rate: 20.9%



Fiscal 1978
Contribution Percent
93% 7-Eleven
7% Gristede's & Other

Ray Berry with Regional Managers (left to right)
Don Nelson, Ben Holland, and Allen Penniman, Jr.

Network Advertising

In January, 1978, Southland introduced its first prime-time network commercial to the largest audience in television history. From that commercial just prior to the Super Bowl XII kickoff through the Jerry Lewis Labor Day Telethon in September, product awareness messages featuring "Hot to Go" coffee, "Egg Hamlette," "Chili Dog," "Slurpee," or sunglasses reached 58 million households each broadcast week. In addition to the network television commercials, advertisements were aired on approximately 500 radio stations and published in more than 200 newspapers nationwide. Southland is substantially expanding its 1979 advertising program as a result of the successful 1978 campaign.

Gristede's

For the year, the 109 stores in the Gristede's Division reported a substantial increase in operating profit, primarily due to increased volume and continued control over operating costs. Serving the greater New York area, the stores specialize in premium-quality groceries, meats, and fresh produce. Many provide unusual customer conveniences, such as telephone ordering, home delivery, and charge accounts. The Division's Charles & Co. shops feature made-to-order sandwiches, snacks, and beverages, while the gourmet stores offer epicurean foods and gift-packed delicacies.

Area Licenses

Eight domestic licensees operating in 20 states added 40 units in 1978, increasing the number of stores to 279 at year-end. New openings included the 75th unit in eastern Michigan by the Company's first licensee.

The most significant international growth occurred in Japan, where conversion of small retail stores to **7-ELEVEN** increased their profitability while responding to shoppers' needs. Since May, 1974, 559 units have been opened, including 211 stores during 1978.

Nine stores were added in Australia during the second year of operation, increasing to 12 the number of **7-ELEVEN** units open at year-end. In addition, the first five stores were opened under a license agreement signed in 1978 for parts of eastern Canada.

International Operations

R S McColl, a wholly-owned subsidiary, operated 383 confectionery, tobacco, and news (CTN) stores in England and Scotland at year-end. Following the successful introduction of the **7-ELEVEN** concept at Milton Keynes, 70 miles northwest of London, in late 1977, six additional stores were opened in 1978. The stores, which offer customers a variety of fresh meats and produce in addition to the conventional **7-ELEVEN** assortment, are experiencing excellent sales.

While sales of McColl increased during the year, operating profits were down slightly due to reduced margins on tobacco products and mandatory increases in labor costs. Southland also has an equity interest in five stores in Mexico and 23 in Sweden.

Sales of international operations and area licensees are not included in Southland's revenues, but earnings and royalties based upon sales are reported as Other Income.

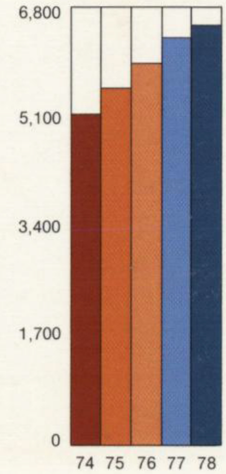
Distribution Centers

Three Distribution Centers in Florida, Virginia, and Texas provide Southland with a distribution system specifically designed to meet the needs of **7-ELEVEN** for a reliable and efficient source of supply, frequent deliveries, and a high in-stock position. The system also provides the stores with the flexibility to respond quickly to customer preferences and seasonal changes in demand, as well as to implement promotional programs and introduce new products. The Centers, which were serving 3,916 **7-ELEVEN**

Store Summary

	Opened	Closed	End of Year
7-ELEVEN			
United States	530	306	6,437
Canada	20	2	162
Total	550	308	6,599
Gristede's	—	5	109
Total	550	313	6,708
R S McColl—United Kingdom			
CTN	15	16	383
7-ELEVEN	6	—	7
Total	21	16	390
7-ELEVEN-Area Licenses			
Japan			559
United States			279
Australia			12
Canada			5
Total			855
Affiliated Stores			
Super Siete—Mexico			5
Näröppet—Sweden			23
Total			28

7-ELEVEN
STORE GROWTH
Number



Dick Dole with Regional Managers (left to right)
Frank Kitchen, Don Burnside, and Adrian Evans

Clark J. Matthews, II (left), Vice President and General Counsel, joined Southland in 1965, and Joe C. Thompson, Jr., Vice President, in 1971.

stores at year-end, made a significant contribution to profits, with sales up 17.7% to $379.6 million, including $12.9 million to outside customers.

Store stock lists, compiled and updated monthly by computer, are tailored to each store's merchandise requirements, enabling personnel to determine easily their restocking needs. The store orders are then transmitted through a network of computer terminals, located at 7-ELEVEN district offices and connected to the computer center in Dallas, which assimilates the orders and transmits them to printing terminals at the appropriate Distribution Center. From the printed lists, the store orders are "picked" and assembled for delivery. Custom designed trucks with separate compartments for dry, chilled, and frozen merchandise follow computer-planned routes to achieve maximum savings of energy and time.

The concept of delivering pre-priced merchandise in less than case quantities eliminates overstocking, assures fresh merchandise on the shelves at all times, promotes more productive use of selling space, and improves store profitability. In addition, a highly efficient computerized inventory control system enabled the Centers in 1978 to achieve an average turnover rate of 23 times while maintaining a 99% order fill rate.

Representatives from the Centers now visit more than 3,000 stores on a regular basis to assist in ordering, displaying, and merchandising certain categories of products. This specialized in-store service program was initiated in 1977, and during the year was expanded to include an additional 1,000 stores.

To extend the advantages of the Company's distribution system to 7-ELEVEN stores in the Midwest, construction was begun in May, 1978, on a fourth Distribution Center near Champaign, Illinois. The 460,000-square-foot facility, scheduled for opening in the fall of 1979, will serve approximately 1,000 stores in an 11-state area.

Fast Foods

Southland continues to increase its share of the rapidly growing "food away from home" market with its popular fast foods program. Greater numbers of women entering the work force, higher family incomes, smaller families, and more single people have created a lifestyle in which approximately 7% of disposable personal income is spent for food prepared outside the home. Industry sources project this market will capture an even larger share of the total United States food dollar in the future.

The Fast Foods Division, with a strong 30.5% sales gain for the year, produces a line of approximately 30 sandwiches, marketed under the 7-ELEVEN and Landshire labels. The sandwiches are distributed either fresh or flash-frozen for convenient heating in microwave or infrared ovens. Three Southland Food Centers, together with Landshire and its distributors, sold approximately 80 million sandwiches in 1978 to 7-ELEVEN stores, other retailers, and institutional customers. The Centers also produced more than one million gallons of syrup for the popular semi-frozen carbonated drink, "Slurpee."

Food Centers are in operation at the three Distribution Centers, and two additional plants are scheduled to open this year in Salt Lake City, Utah, and the new Distribution Center in Champaign.

Percent Convenience Stores Sales (by Principal Product Category)

	1978	1977	1976	1975	1974
Groceries	**13.4%**	14.0%	14.6%	15.3%	17.1%
Gasoline	**13.4**	9.8	6.8	3.9	2.7
Tobacco Products	**12.9**	14.2	14.7	15.6	15.7
Beer/Wine	**12.9**	13.7	14.4	14.8	14.1
Soft Drinks	**10.9**	11.0	10.7	11.5	11.5
Non-Foods	**9.4**	9.9	10.2	9.5	9.3
Dairy Products	**8.9**	9.3	9.6	9.9	10.5
Other Food Items	**5.5**	4.7	4.7	4.2	3.9
Candy	**4.7**	5.0	5.4	5.7	5.3
Baked Goods	**4.6**	5.0	5.3	5.7	5.9
Health/Beauty Aids	**3.4**	3.4	3.6	3.9	4.0
Total	**100.0%**	100.0%	100.0%	100.0%	100.0%

The Company does not record sales by product lines but estimates the percentage of convenience store sales by principal product category based upon total store purchases.


: DC04
LOCATIONS BY AISLE
ENTER AISLE FOR DISPLAY, 'N' FOR NEXT PAGE, 'P' FOR PRIOR PAGE
ENTER 'E' FOR EMPTY, 'F' FOR FULL, 'A' FOR ALL
LOCATION ITEM LOC DU ON HAND CENTS OFF FIFO STATUS
E-01-1001- 122904 24 28 0 1
E-01-1002- 01759 144 19 0 3
E-01-1005- 03182 36 34 0 2
E-01-1006- 03174 36 18 0 2
E-01-1009- 00000 0 *EMPTY*
E-01-1010- 02917 36 13 0 5
E-01-1013- 01708 144 3 0 2
E-01-1014- 102806 12 87 0 2
E-01-1017- 128864 144 18 0 3
E-01-1018- 04456 12 56 0 2
E-01-1021- 128864 144 10 0 1
E-01-1022- 102806 12 37 0 1
E-01-1025- 01759 144 8 0 1
E-01-1026- 03182 36 34 0 3


HAM & CHEESE SANDWICH
HAM & CHEESE SANDWICH
HAM & CHEESE SANDWICH
HAM & CHEESE SANDWICH
HAM & CHEESE SANDWICH

M. T. Cochran, Jr. (left), Vice President, Dairies Group, joined Southland in 1957, and Jim Parker, General Manager, Dairies Group, in 1970.

DAIRIES GROUP

The Dairies Group is a major processor and distributor of milk, ice cream, and related dairy products, including yogurt, ultra-pasteurized creams, juices, eggnog, dips, and toppings. From 28 processing plants and 86 distribution points serving customers in 34 states and the District of Columbia, products are marketed under 11 well-known regional brand names.

Total sales increased 7.4% to $388.4 million, including $252.8 million to outside customers, which represents 8% of total corporate sales. Intracompany sales rose 7.8% to $135.6 million as 7-ELEVEN stores aggressively merchandised the Group's expanding dairy product line. Southland Dairies serve 5,295 convenience stores, supplying approximately 66% of the dairy products sold in all 7-ELEVEN stores.

Dairies Group operating profits increased substantially from 1977 levels as overall market conditions improved. However, some markets continued to experience severe competition and resistance to price adjustments to offset increases in farm milk, distribution, and general business costs. The effect on Southland of these conditions was lessened by the geographic spread of the Group's operations and overall processing efficiencies attributable to sustained plant modernization and automation programs.

In August, Specialty Foods, a division of the Dairies Group, opened a new plant in Ft. Worth, Texas, doubling that unit's capacity to produce a line of 10 popular salads for distribution to 7-ELEVEN stores and outside customers. The Division also processes sandwich ingredients for the popular fast foods program.

The newest member of the Dairies Group, Lilly Ice Cream Company, has distribution in San Antonio, Houston, Bryan, and other cities in central Texas.

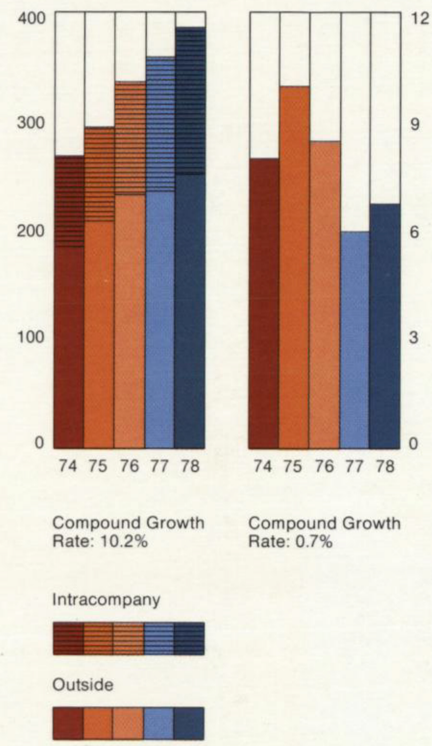
Distribution of the popular line of frozen dairy novelties, including the "Big Deal," "Gram Daddy," and "Big Wheel," has been expanded, and production capacity will be increased again in 1979 at the Oak Farms plant in Dallas. Selected Dairies Group products will be featured for the first time in commercials scheduled for prime-time network television in 1979.

Customer demand for natural-flavored ice creams increased significantly during the year, and the Dairies Group gained additional industry recognition as its Swiss-style strawberry yogurt received a first-place award presented by The American Cultured Dairy Products Institute. A new line of sundae-style yogurts will be introduced during 1979 in a variety of flavors.

In addition to its support of numerous charities, including United Way and the Jerry Lewis Muscular Dystrophy Telethon, the Dairies Group in 1978 became the first nationwide corporate sponsor of the March of Dimes. The Group assisted that organization to increase public awareness of, and recruit volunteers for, the Mother's March Against Birth Defects held in late January, 1979.

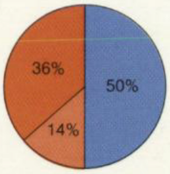
DAIRIES GROUP SALES
(Including Intracompany)
In Millions

DAIRIES GROUP OPERATING PROFIT
In Millions



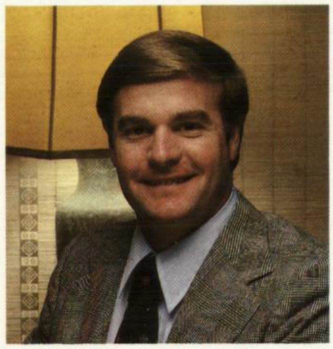
Compound Growth Rate: 10.2%

Compound Growth Rate: 0.7%



Fiscal 1978
Contribution Percent
By Customer
50% Wholesale
36% Intracompany
14% Distributor & Other


Bob
Embassy
HOMOGENIZED
VITAMIN D MILK
THE EMBASSY PLEDGE



Joe Hardin, Jr., Operations Manager, Special Operations Group, joined Southland in 1972.

SPECIAL OPERATIONS GROUP

The Special Operations Group consists of businesses which provide services and products to the Company, as well as to a growing number of outside customers. The Group's sales increased 17.4% in 1978 to $55 million. Outside sales, which contributed 1% of total Company sales, increased 22.8% to $39.7 million, while intracompany sales were $15.3 million, up 5.3% from the previous year.

Chemical

Sales increased 25.3% as the Division continued to expand distribution of its broad line of specialty chemicals for domestic and international markets. Although 77% of sales were to outside customers, the Division supplies Southland operations with a variety of products, such as "Slurpee" concentrates, food ingredients and preservatives, sanitizers, and cleansing agents.

In May, the Company acquired a "fine chemicals" plant, located near Great Meadows, New Jersey, which specializes in organonitrogen chemistry. The nitration production capacity of the plant has been expanded by five million pounds per year, enabling the Division to market a broader line of products to the fastest-growing segments of the agricultural and pharmaceutical industries.

To meet additional demand, the Division expanded production capacity at the Dallas plant during the year for the manufacture of sodium acetate, which has wide industrial applications. At the Sanford, Florida, plant a chill beading tower was installed for the production of emulsifiers and dough softeners and strengtheners.

Chemical's added production facilities, increased capacity, expansion and diversity of product lines, wider distribution, and broader customer base provide new opportunities for growth and profitability.

BAKERY PRODUCTS
- Dough Strengtheners and Softeners
- Mold Inhibitors
- Flavors
- Cleaners/Sanitizers
- Pan Oils
- Variety Bread Bases
- Dough Driers
- Fruit Toppings

LEATHER TANNING
- Tanning Extracts
- Leather Impregnants
- Leather Conditioners
- Equipment

SOAP AND DETERGENT
- Fats and Oils
- Fatty Acids
- Surface Active Agents
- Waxes
- Chelates

TEXTILE
- Sodium Acetates
- Defoamers
- Dyestuff Dispersants

DAIRY
- Flavors
- Ice Cream Stabilizers
- Cleaners/Sanitizers
- Fruit Products
- Drink Bases

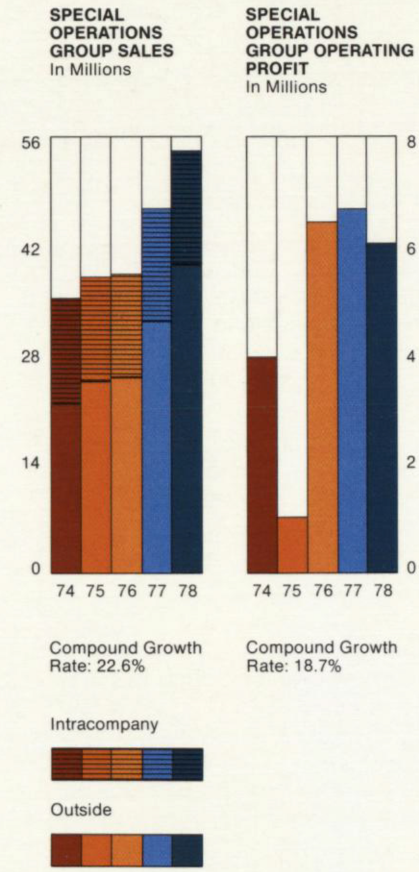
SPECIALTY COATINGS
- Mirror Backing
- Can Sealants
- Inks
- Baking Enamels
- Gums and Resins

BEVERAGE
- Sodium Benzoate
- Flavor Concentrates
- Cleaners/Sanitizers

MISCELLANEOUS
- Lignosulfonates
- Lanolins
- Food Grade Emulsifiers
- Lithium Hypochlorite
- Paper Defoamers

PHARMACEUTICAL
- 8-Hydroxyquinoline Citrate
- 8-Hydroxyquinoline Sulfate
- 2-Nitro-p-Phenylene Diamine
- 2-Nitro-p-Aminophenol
- 2-Acetothiophene
- 6-Methoxytetralone-1
- 2-phenoxymethylbenzoic Acid
- Phthalide

AGRICULTURAL INTERMEDIATES
- 4 Chloro, 3, 5 dinitrobenzotrifluoride



Reddy Ice

Reddy Ice manufactures packaged and commercial ice at plants in Dallas, Waco, Houston, Austin, Ft. Lauderdale, and Las Vegas for distribution through **7-ELEVEN** stores and other outlets. Sales to outside customers accounted for 69% of total volume.

During the summer of 1978, demand for ice exceeded production capacity and boosted sales 11.3% to record levels for the year. In addition to established markets in California,

Nevada, Arizona, Florida, and Texas, Reddy Ice expanded distribution during the year into Utah, Louisiana, and Arkansas. To meet sales demand in the Texas market, the largest fully automated ice manufacturing facility in the United States, with annual capacity in excess of 100,000 tons, was recently completed in Dallas.

Hudgins

Hudgins Truck Rental operates 24 service centers, including 18 in Texas, two in Missouri, and one each in Tennessee, Alabama, Virginia, and Florida. Six of these were added during the year to expand service and provide more efficient full-maintenance truck leasing to national and regional customers, as well as to Southland operations. The 25th branch is scheduled to open in late 1979 at the new Southland Distribution Center in Champaign, Illinois. Outside sales were up 10% and accounted for 68% of revenues.

Tidel

A new division added in 1978, Tidel Systems manufactures an innovative money handling device designed specifically for use by 7-ELEVEn and other retailers. The "Timed Access Cash Controller" utilizes a microprocessor for time-delayed access to money stored within a "hardened area" similar to a safe. The equipment increases security, cash handling efficiency, and customer convenience by enabling the withdrawal of a limited amount of cash at pre-set time intervals for cashing checks and making change.

Tidel occupies a 125,000-square-foot facility in Dallas. Plans are being formulated for a nationwide distribution and maintenance organization.

Chief Auto Parts

In December, 1978, Southland acquired Chief Auto Parts, a chain of 119 retail automobile supply stores in southern California. Chief, founded in 1966, has established an excellent growth record.

The approximate cost of Chief's net assets was $20 million payable over a two-year period through January 2, 1981. The Company also obtained a consultation and noncompetition agreement from the seller for $7.5 million in cash, which will be amortized over a five-year period.

A typical Chief store is 2,000 square feet in size, open seven days a week, and located in a neighborhood shopping center close to customers' homes or businesses. The stores, which offer approximately 7,500 replacement parts and accessories, feature nationally known brands, as well as private-label products. The average purchase is $5, with a large percentage of sales on weekends when most do-it-yourselfers have time to service their automobiles. Chief operates a modern warehouse in the Los Angeles area, enabling stores to maintain a high in-stock position for maximum sales.

Today, transportation is one of the larger expenditures of the average family. The cost of operating and maintaining an automobile has risen dramatically since the early 1970's because of higher fuel prices, more complicated anti-pollution equipment, and the rapidly rising cost of labor and parts. Individuals have responded to these increased costs in a number of ways, including more do-it-yourself maintenance.

Industry figures show that more than 50% of all owners undertake either all or part of their car's maintenance, and the older the vehicle, the more likely the work will be done by the home auto mechanic.


ELEVEN
FOOD STORES
OPEN 24 HOURS
ELEVEN
YOUR NEIGHBORHOOD STORE

FINANCIAL SUMMARY

THE SOUTHLAND CORPORATION AND SUBSIDIARIES

(Dollars in thousands except per share data)

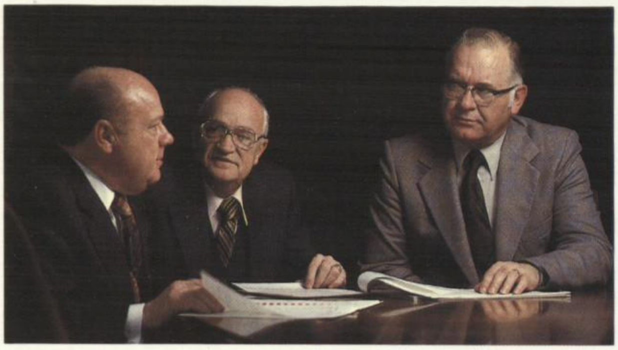
	Years Ended December 31				
	1978	1977	1976	1975	1974
Operations (Note 1)					
Total revenues	**$3,090,094**	$2,545,415	$2,122,023	$1,790,805	$1,614,188
Increase over prior year	**21.40%**	19.95%	18.50%	10.94%	15.47%
Net earnings	**57,097**	45,317	37,849	32,068	27,167
Increase over prior year	**25.99%**	19.73%	18.03%	18.04%	25.85%
Per revenue dollar	**1.85%**	1.78%	1.78%	1.79%	1.68%
Return on beginning shareholders' equity	**17.30%**	15.62%	14.56%	13.72%	13.16%
Assets Employed (Note 1)					
Working capital	**141,633**	136,693	101,536	80,196	72,495
Current ratio	**1.54**	1.66	1.63	1.58	1.55
Property, plant, and equipment including capital leases (net)	**677,284**	567,442	506,190	447,392	406,486
Depreciation and amortization	**67,724**	61,735	55,029	47,974	43,078
Total assets	**1,134,476**	942,531	799,261	696,107	639,599
Capitalization (Note 1)					
Long-term debt	**261,460**	195,520	153,093	119,911	105,609
Capital lease obligations	**211,342**	192,547	178,556	163,380	155,918
Shareholders' equity	**374,467**	329,952	290,142	259,940	233,659
Total capitalization	**847,269**	718,019	621,791	543,231	495,186
Shareholders' equity to total capitalization	**44.20%**	45.95%	46.66%	47.85%	47.19%
Per Share Data (Notes 1 and 2)					
Primary earnings	**2.83**	2.26	1.92	1.63	1.42
Earnings assuming full dilution	**2.74**	2.19	1.85	1.58	1.35
Cash dividends	**.68**	.55	.44	.36	.30
Shareholders' equity	**18.55**	16.48	14.68	13.23	12.21
Other Data					
Cash dividends	**13,627**	10,961	8,660	7,033	5,834
Dividends as a % of earnings (Note 1)	**23.87%**	24.19%	22.88%	21.93%	21.47%
Stock dividends	**3%**	3%	3%	3%	3%
Average shares outstanding (Note 3)	**20,181,879**	20,015,512	19,761,788	19,642,947	19,137,414
Average diluted shares (Note 3)	**21,129,981**	21,028,143	20,911,047	20,883,719	20,854,737
Market price range (Note 3)					
High	**33¾**	25⅞	26⅛	26¼	18⅞
Low	**21½**	19¼	19⅛	14	11⅜
Year-end	**26¾**	24⅝	25½	20⅜	14¼
Number of shareholders	**8,627**	8,764	8,881	9,093	9,351
Number of employees	**37,000**	34,000	31,000	28,600	28,200

Notes:

(1) The years 1974 through 1977 have been restated for the change in the method of accounting for leases, to comply with the provisions of Statement of Financial Accounting Standards No. 13 (see Note 2 to the consolidated financial statements) which was adopted early in accordance with the requirements of the Securities and Exchange Commission.

(2) Based on average shares outstanding adjusted for stock dividends.

(3) Adjusted for stock dividends.



P. Eugene Pender (left), Controller, joined Southland in 1971; W. K. Ruppenkamp (center), Vice President, Financial Relations, in 1965; and R G Smith, Secretary and Treasurer, in 1951.

Lease Accounting Change

The Securities and Exchange Commission mandated early application in 1978 of Statement of Financial Accounting Standards No. 13 (SFAS 13), including subsequent interpretations, which prescribes new accounting rules for leases. Accordingly, the financial statements and other financial information for 1978 and prior years in this Report reflect capital lease assets and related long-term lease obligations, as well as imputed interest expense and amortization, rather than actual rent expense. This accounting change reduced primary earnings per share by 12 cents in 1977 and four cents in 1978.

Revenues

Consolidated revenues exceeded three billion dollars in 1978, just two years after achieving the two billion dollar level. Revenues reached a record $3.090 billion, up $544.7 million over the previous all-time high of $2.545 billion for 1977. The exceptionally strong 21.4% increase, primarily resulting from continued internal growth in Southland's major business, 7-Eleven stores, substantially exceeded the Company's five year compound growth rate of 17.2%. The Stores Group represented 90% of total corporate revenues while Dairies Group accounted for 8% and Special Operations Group the remaining 2%.

7-Eleven sales, representing 84% of Company sales, rose 23.5% through more efficient use of selling space and higher volume in established stores, a substantial increase in demand for self-serve gasoline, as well as the net addition of 242 new stores. Stores Group sales were up 22.8% while the Dairies Group increased 7.2%, and Special Operations Group showed a gain of 22.8%.

Revenues (Millions)

QUARTER	1978	1977	% Gain
First	**$ 648.8**	$ 537.1	20.8
Second	**777.6**	648.4	19.9
Third	**848.3**	694.3	22.2
Fourth	**815.4**	665.6	22.5
TOTAL	**$3,090.1**	$2,545.4	21.4

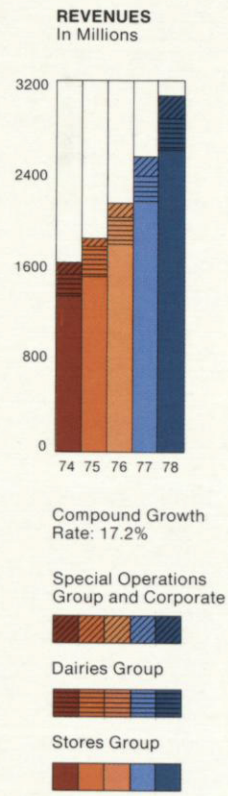
Net Earnings

Net earnings also reached a new high of $57.1 million, up $11.8 million from 1977 earnings of $45.3 million. The excellent 26.0% increase over last year's strong earnings gain was primarily the result of additional convenience store volume, successful advertising and merchandising programs, maintenance of overall profitability, and continued emphasis on programs to reduce operating costs and improve productivity.

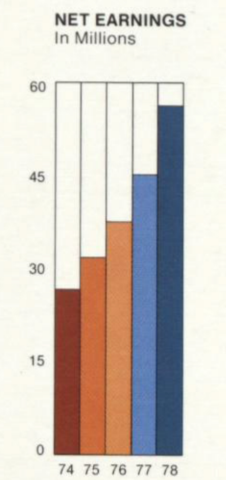
Net return on revenues for the year improved to 1.85% from 1.78%, one of the highest after-tax profit margins of any major food retailer. One of the Company's primary objectives is to improve its net return on each dollar of revenue while maximizing sales.

Net Earnings (Thousands)

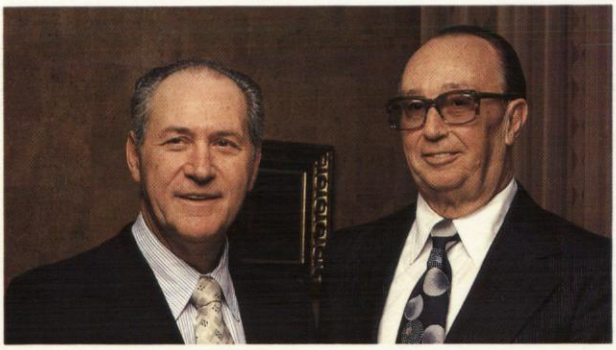
QUARTER	1978	1977	% Gain
First	**$ 7,061**	$ 5,523	27.8
Second	**18,238**	14,538	25.5
Third	**19,114**	15,525	23.1
Fourth	**12,684**	9,731	30.3
TOTAL	**$57,097**	$45,317	26.0



Compound Growth Rate: 17.2%



Compound Growth Rate: 21.5%



Vaughn R. Heady (left) and Forrest Stout, Vice Presidents, joined Southland in 1948.

Earnings Per Share

Primary earnings per share were $2.83, up 25.2% over 1977 earnings of $2.26. Average shares outstanding were 20,181,879, compared with the prior year's 20,015,512.

Primary*

QUARTER	1978	1977	% Gain
First	**$ .35**	$ .28	25.0
Second	**.90**	.73	23.3
Third	**.95**	.77	23.4
Fourth	**.63**	.48	31.3
TOTAL	**$2.83**	$2.26	25.2

Assuming full dilution, earnings per share were $2.74, up 25.1% from 1977 earnings of $2.19. Diluted earnings were computed on the basis of 21,129,981 average shares, compared with 21,028,143 a year earlier.

Diluted*

QUARTER	1978	1977	% Gain
First	**$ .35**	$ .27	29.6
Second	**.87**	.70	24.3
Third	**.91**	.75	21.3
Fourth	**.61**	.47	29.8
TOTAL	**$2.74**	$2.19	25.1

During the past five years, Southland's primary and diluted earnings per share have increased at an average annual compound rate of 20%.

* Adjusted for 3% stock dividend in each year.

Dividends

The annual cash dividend rate was increased 20% in April, 1978, to 72 cents from 60 cents a share. Total cash dividends distributed during the year were $13,627,443, an increase of 24.3% over the $10,960,976 paid the previous year. In 1978, 23.9% of net earnings were paid to shareholders, compared with 24.2% a year ago.

Dividends Paid per Common Share

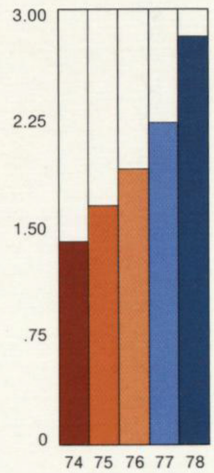
CASH:		
QUARTER	**1978**	1977
First	**$.15**	$.12½
Second	**.18**	.15
Third	**.18**	.15
Fourth	**.18**	.15
TOTAL	**$.69**	$.57½
STOCK:	**3%**	3%

Southland has declared cash dividends each of the past 22 years, and the annual rate has been raised 12 times. The Company has not only followed a policy of reinvesting a major portion of net earnings to meet its ambitious growth objectives but also has increased the annual cash dividend rate seven times in the past eight years, providing shareholders with an average annual compound growth rate of 20.7%. For the 13th consecutive year, a 3% stock dividend was distributed. The Company has declared stock dividends or stock splits each year since 1958 except in 1964.

Shareholders' Equity

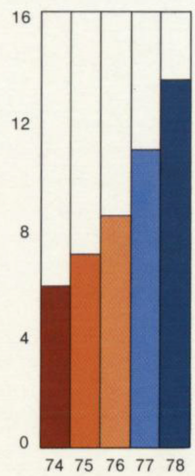
Shareholders' equity rose to $374.5 million at year-end, compared with $330.0 million the prior year, reflecting a compound annual growth rate of 12.7% over the past five years. Return on beginning shareholders' investment (net earnings divided by equity) increased to 17.3%, compared with 15.6% for the previous year.

PRIMARY EARNINGS PER SHARE
In Dollars



Compound Growth Rate: 19.9%

DIVIDENDS
In Millions



Compound Growth Rate: 27.2%

At December 31, 1978, 20,200,557 shares of common stock were outstanding, compared with 19,557,287 shares a year earlier, an increase of 643,270 shares. The 3.3% increase is the result of issuing 584,187 shares in payment of a 3% stock dividend, 19,523 shares under the key employees incentive plan, 39,554 upon the exercise of stock options, and six relating to a previous acquisition. At year-end, 873,684 shares were reserved for issuance upon conversion of outstanding notes and debentures and 584,427 for issuance under a stock option plan and a key employees incentive plan.

Book value per share (shareholders' equity divided by average primary shares outstanding) was $18.55, compared with $16.48 at the close of 1977, an increase of 12.6%.

Capital Investment

Capital investment for property, plant, and equipment during the year totaled $152.4 million, the largest amount in Southland's history and $46.4 million more than in 1977.

The Stores Group accounted for $110.5 million, or 73% of total expenditures, principally for new 7-Eleven stores, self-serve gasoline installations, replacement of equipment, remodeling and expansion of existing facilities, and future store sites.

Outlays for the Dairies Group were $9.7 million, or 6%, for vehicles, new product capacity, and manufacturing and productivity improvement. Capital investments of $23.1 million, or 15%, for the Special Operations Group included the acquisition of a chemical plant in New Jersey, the addition of a new ice processing plant in Dallas, and equipment for the truck leasing division. Corporate capital expenditures were $9.1 million.

In addition to owned fixed assets of $479.6 million at December 31, 1978, the Company utilizes in its business leased real estate and equipment, $197.7 million of which is now capitalized in the financial statements in accordance with SFAS 13. The Company considers such leases to be extremely valuable assets and essential to conducting its business.

Southland is confident that many opportunities are available to expand its sales and earnings base and plans to vigorously pursue those opportunities. Our capital expenditure plans call for continued major investment to expand operations, particularly 7-Eleven stores, maintain modern and up-to-date facilities, increase productivity, and enlarge capacity to meet anticipated customer demand.

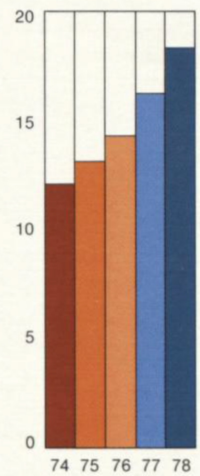
Financial Position

Working capital (current assets minus current liabilities) increased $4.9 million to $141.6 million at the close of 1978, compared with $136.7 million the previous year. The ratio of current assets to current liabilities was 1.54 to 1, compared with 1.66 to 1 a year earlier.

To provide adequate financing for planned corporate growth through expansion of existing facilities, acquisitions, and new ventures, Southland has traditionally utilized the most advantageous combination of funds provided from operations, debt, equity, and lease financing. Although it is a long-term goal to finance expansion from retained earnings, other methods of financing are utilized in order for the Company to take advantage of the many opportunities available to add productive assets for systematic sales and earnings growth.

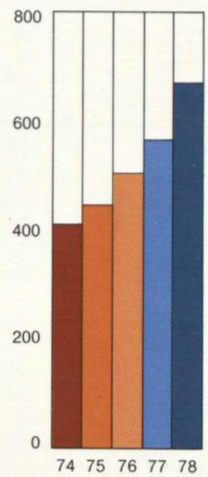
While Southland prefers to own the premises from which it conducts its store operations, many desirable locations are available only on a long-term lease basis. At year-end, approximately 60% of the Company's convenience store operations were conducted under leases now defined as capital leases and are capitalized in the financial statements in accordance with SFAS 13. Accordingly, as of

SHAREHOLDERS' EQUITY PER SHARE
In Dollars



Compound Growth Rate: 11.3%

PROPERTY, PLANT AND EQUIPMENT (NET)
(Including Capital Leases)
In Millions



The first 7-ELEVEN store in the United Kingdom at Milton Keynes, near London

December 31, 1978, $197.7 million of capital lease assets and $211.3 million in capital lease obligations are reflected on the balance sheet.

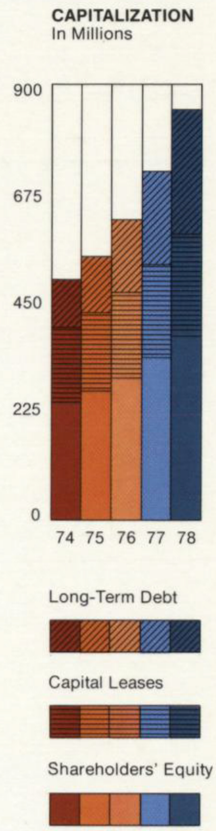
During the year, long-term debt increased a net of $65.9 million to $261.5 million, primarily reflecting the $16.9 million in notes issued in the acquisition of Chief Auto Parts and the issuance in December, 1978, of $50 million 9⅜% Sinking Fund Debentures due December 15, 2003.

The Company's 8⅜% Sinking Fund Debentures, as well as the new 9⅜% Debentures, are rated "A" by both Moody's and Standard & Poor's.

Total capitalization (long-term debt, capital lease obligations, and shareholders' equity) at year-end was $847.3 million, compared with $718.0 million a year earlier. The effect of including capital lease obligations on the Company's capital structure is as follows:

Total Capitalization (Millions)

	1978		1977	
	Amount	**%**	Amount	%
Long-Term Debt	**$261.5**	**30.9**	$195.5	27.2
Capital Lease Obligations	**211.3**	**24.9**	192.5	26.8
Shareholders' Equity	**374.5**	**44.2**	330.0	46.0
TOTAL	**$847.3**	**100.0**	$718.0	100.0



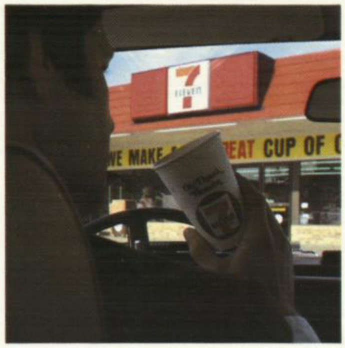
Profit Sharing and Pension Plans

The Company contributes to The Southland Corporation Employees' Savings and Profit Sharing Plan, established in 1949, and to various union pension plans. Eligible employees have the option of joining Southland's voluntary contributory plan. Company contributions to this fully funded, trustee-administered plan are based on pretax earnings. All required contributions to union pension plans have been made.

Market Data

Southland's common stock is traded under the symbol SLC on the New York, Pacific, Boston, and Philadelphia Stock Exchanges. The following market price and earnings per share information has been adjusted for a 3% stock dividend in each year. The price/earnings ratios are based upon primary earnings per share for the four preceding quarters.

QUARTER	PRICE RANGE		PRICE/ EARNINGS RATIO	
1977	High	Low	High	Low
First	25⅞	20¾	13.5	10.8
Second	22¾	19¼	11.6	9.8
Third	24⅝	21¾	11.7	10.4
Fourth	25½	22⅝	11.4	10.1
1978				
First	**25**	**21¾**	**11.1**	**9.6**
Second	**29⅛**	**21½**	**12.5**	**9.2**
Third	**33¾**	**25½**	**13.5**	**10.2**
Fourth	**30⅞**	**25**	**11.5**	**9.3**

Corporate Taxes

Federal, state, and local taxes have a major impact on the Company's earnings. In 1978, after all other costs of doing business, Southland's taxes totaled $97.3 million, or 63% of income before all taxes, leaving only $57.1 million, or 37% of profits, available for reinvestment in the growth of the Company and for dividends to shareholders.

Income Before All Taxes		$154,456,000	100%
Taxes on Income	55,611,000		
Payroll Taxes	25,395,000		
Other Taxes	16,353,000		
Total Taxes		97,359,000	63%
Net Earnings		$ 57,097,000	37%

Management's Discussion and Analysis of the Consolidated Statements of Earnings

Fiscal Year 1978 Compared with Fiscal Year 1977

In 1978, revenues increased $544.7 million to $3.090 billion, compared with $2.545 billion for 1977. The excellent 21.4% increase was a result of successful merchandising and advertising programs, gain in average sales volume per store, more aggressive pricing of selected products in convenience stores, a substantial increase in sales of self-serve gasoline, and the opening of new 7-Eleven stores. The Company opened 550 convenience stores and closed 308, for a net of 242 stores in 1978, compared with 404 in 1977.

Other income rose from $9,306,000 to $13,562,000 primarily as a result of a substantial increase in interest income from investment of surplus funds at a higher rate of return, area license royalties, and net gain on sale of assets no longer of use to the Company.

Gross margin for the year was maintained at the 1977 level of 25.21%. A substantial increase in sales of self-serve gasoline, a high-volume, low-margin product available at 1,857 7-Eleven stores at year-end, offset merchandise margin gains in convenience stores and dairies.

The excellent sales gain contributed to a reduction in the ratio of expenses to revenues from 21.67% in 1977 to 21.56% in 1978. Sales increased 21.3%, cost of goods sold, including buying and occupancy expenses, increased 21.4%, and expenses (selling, general and administrative expenses, interest expense, and contributions to Employees' Savings and Profit Sharing Plan) increased 20.8%, compared with 1977. Interest expense rose from $13,540,000 to $15,804,000, primarily as a result of the $50 million 8⅝% debentures sold in March, 1977, and mortgage debt incurred to finance new 7-Eleven stores. Imputed interest expense on capital lease obligations, accounted for in accordance with SFAS 13, increased from $18,064,000 in 1977 to $19,325,000 in 1978.

Contributions to the Employees' Savings and Profit Sharing Plan rose 20.4% in 1978 to $11.7 million, compared with $9.7 million in 1977, as the result of increased earnings before income taxes.

A reduction in the ratio of expenses to revenues resulted in net return on revenues of 1.85%, compared with 1.78% for 1977. Net earnings were a record $57.1 million, up 26.0% from 1977 earnings of $45.3 million.

Fiscal Year 1977 Compared with Fiscal Year 1976

In 1977, revenues increased $423.4 million to $2.545 billion, compared with $2.122 billion for 1976. The exceptionally strong 19.9% increase was a result of successful merchandising and advertising programs, gain in average sales volume per store, competitive pricing of selected products in the convenience stores, a substantial increase in sales of self-serve gasoline, and the opening of new 7-Eleven stores. The Company opened a net of 404 convenience stores in 1977, compared with 374 the previous year.

Other income rose from $6,254,000 to $9,306,000 primarily as a result of increases in interest income from investment of surplus funds, area license royalties, and net gain on sale of assets no longer of use to the Company.

Gross margin for the year was 25.21%, compared with 25.68% for 1976. The decline resulted from sustained pressure on already modest dairy margins due to higher farm milk costs, severe competition in many market areas, resistance to price adjustments, and an increase in general business costs. In addition, margins were influenced by promotional programs, competitive pricing of selected items in convenience stores, and a changing product mix, including a substantial increase in sales of self-serve gasoline, a high-volume, low-margin product available at 1,573 7-Eleven stores at year-end.

The excellent sales gain contributed to a reduction in the ratio of expenses to revenues from 22.11% in 1976 to

Artist's rendering and ground breaking ceremony, Distribution Center, Champaign, Illinois

21.67% in 1977. Sales increased 19.9%, cost of goods sold, including buying and occupancy expenses, increased 20.7%, and expenses (selling, general and administrative expenses, interest expense, and contributions to Employees' Savings and Profit Sharing Plan) increased 17.6%, compared with 1976. Interest expense rose from $9,707,000 to $13,540,000, primarily as a result of the $50 million 8⅜% debentures sold in March, 1977, and mortgage debt incurred to finance new 7-Eleven stores. Imputed interest expense on capital lease obligations, accounted for in accordance with SFAS 13, increased from $15,388,000 in 1976 to $18,064,000 in 1977.

Contributions to the Employees' Savings and Profit Sharing Plan rose 16.5% in 1977 to $9.7 million, compared with $8.3 million in 1976, as the result of increased earnings before income taxes.

A lower gross margin, offset by a reduction in the ratio of expenses to revenues, resulted in net return on revenues of 1.78%, the same as 1976. Net earnings were a record $45.3 million, up 19.7% from 1976 earnings of $37.8 million.

Management's Responsibility For Financial Reporting

The consolidated financial statements of The Southland Corporation and Subsidiaries, as well as other financial information contained in this Report, were prepared by management, which is responsible for their integrity and objectivity. The Company's financial position and results of operations have been presented in conformity with generally accepted accounting principles and, where appropriate, reflect estimates based on judgments of management.

Touche Ross & Co., independent certified public accountants, are engaged to examine the financial statements and issue reports thereon. Their examination is conducted in accordance with generally accepted auditing standards, including a review of internal controls and such tests of the accounting records as they consider necessary.

The Company, in addition to the use of outside independent accountants, has developed a system of internal controls designed to provide reasonable assurance that all transactions are accurately reflected on the books and records, assets are protected, established policies and procedures are followed, and the Company's financial position is presented fairly in the consolidated financial statements. This system is augmented by a professional staff of internal auditors who coordinate their activities with the independent accountants.

The Board of Directors, through its Audit Committee consisting of three outside directors, is responsible for assuring that management fulfills its responsibilities in the preparation of the financial statements and for recommending the engagement of the independent accountants with whom the Committee reviews the scope of the audit and the accounting principles to be applied in financial reporting. The Committee meets as necessary, but a minumum of three times a year, with representatives of management, the independent accountants, and the internal auditors to review their work. The independent accountants and internal auditors have direct access to the Committee, with or without the presence of management representatives, to discuss any appropriate matter.

Segment Information (Excluding Intersegment Sales) (Millions)

	Years Ended December 31									
	1978		1977		1976		1975		1974	
Revenues:										
Stores Group	**$2,791.0**	**90%**	$2,271.9	89%	$1,857.5	88%	$1,556.0	87%	$1,405.4	87%
Dairies Group	**253.4**	**8**	236.5	9	236.1	11	208.3	12	184.0	11
Special Operations Group	**40.9**	**2**	33.7	2	26.0	1	25.0	1	22.6	2
Corporate	**4.8**	**—**	3.3	—	2.4	—	1.5	—	2.2	—
TOTAL	**$3,090.1**	**100%**	$2,545.4	100%	$2,122.0	100%	$1,790.8	100%	$1,614.2	100%
Operating Profits:										
Stores Group	**$ 142.7**	**92%**	$ 115.7	90%	$ 92.3	86%	$ 80.8	88%	$ 68.5	85%
Dairies Group	**6.7**	**4**	6.0	5	8.6	8	10.1	11	8.1	10
Special Operations Group	**6.0**	**4**	6.7	5	6.4	6	.9	1	4.0	5
TOTAL	**$ 155.4**	**100%**	$ 128.4	100%	$ 107.3	100%	$ 91.8	100%	$ 80.6	100%

Grand opening of the 500th **7-ELEVEN** store in Japan, September, 1978

CONSOLIDATED STATEMENTS OF EARNINGS

THE SOUTHLAND CORPORATION AND SUBSIDIARIES

Years ended December 31 (Dollars in thousands except per share data)

	1978	1977	1976	1975	1974
Revenues:					
Net sales	**$3,076,532**	$2,536,109	$2,115,769	$1,787,928	$1,609,257
Other income	**13,562**	9,306	6,254	2,877	4,931
	3,090,094	2,545,415	2,122,023	1,790,805	1,614,188
Cost of Sales and Expenses:					
Cost of goods sold, including buying and occupancy expenses	**2,311,024**	1,903,791	1,577,141	1,323,799	1,184,835
Selling, general, and administrative expenses	**619,519**	510,337	435,687	374,234	348,797
Interest expense	**15,804**	13,540	9,707	7,936	8,674
Imputed interest expense on capital lease obligations	**19,325**	18,064	15,388	13,969	12,982
Contributions to Employees' Savings and Profit Sharing Plan	**11,714**	9,726	8,346	6,995	5,899
	2,977,386	2,455,458	2,046,269	1,726,933	1,561,187
Earnings Before Income Taxes	**112,708**	89,957	75,754	63,872	53,001
Income Taxes (Note 11)	**55,611**	44,640	37,905	31,804	25,834
Net Earnings	**$ 57,097**	$ 45,317	$ 37,849	$ 32,068	$ 27,167
Per Share (Note 12):					
Primary earnings	**$2.83**	$2.26	$1.92	$1.63	$1.42
Earnings assuming full dilution	**$2.74**	$2.19	$1.85	$1.58	$1.35

See notes to consolidated financial statements.

CONSOLIDATED BALANCE SHEETS

THE SOUTHLAND CORPORATION AND SUBSIDIARIES

ASSETS

	December 31 1978	December 31 1977
Current Assets:		
Cash and short-term investments (Note 4)	**$ 82,745,504**	$ 65,903,801
Accounts and notes receivable (Note 5)	**78,968,103**	75,171,378
Inventories	**161,254,967**	126,913,578
Deposits and prepaid expenses	**26,777,392**	21,436,624
Investment in properties	**55,857,419**	53,319,492
Total Current Assets	**405,603,385**	342,744,873
Investments in Affiliates (Note 1)	**27,364,352**	26,717,136
Property, Plant, and Equipment (Note 6)	**479,554,364**	389,251,583
Capital Leases (Note 10)	**197,730,040**	178,190,671
Other Assets (Note 3)	**24,223,652**	5,627,054
	$1,134,475,793	$942,531,317

LIABILITIES AND SHAREHOLDERS' EQUITY

	December 31 1978	December 31 1977
Current Liabilities:		
Accounts payable and accrued expenses	**$ 211,920,848**	$168,894,391
Income taxes	**18,636,987**	15,481,417
Long-term debt due within one year (Note 7)	**13,254,868**	4,142,055
Capital lease obligations due within one year (Note 10)	**20,157,217**	17,533,856
Total Current Liabilities	**263,969,920**	206,051,719
Deferred Credits (Note 8)	**23,235,908**	18,460,424
Long-Term Debt (Note 7)	**261,460,472**	195,520,000
Capital Lease Obligations (Note 10)	**211,342,074**	192,546,677
Commitments for Operating Leases (Note 10)		
Shareholders' Equity (Notes 7 and 9)**:**		
Common stock, $.01 par value, authorized 40,000,000 shares, issued and outstanding 20,200,557 and 19,557,287 shares	**202,006**	195,573
Additional capital	**242,339,822**	223,499,143
Retained earnings	**131,925,591**	106,257,781
	374,467,419	329,952,497
	$1,134,475,793	$942,531,317

See notes to consolidated financial statements.

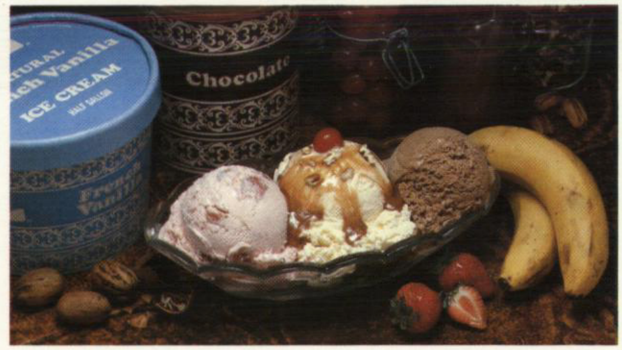
Grand opening of first
"City Store" in New York

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

THE SOUTHLAND CORPORATION AND SUBSIDIARIES

	Year ended December 31	
	1978	1977
Common Stock:		
Balance, beginning of year	**$ 195,573**	$ 186,508
3% Stock dividend	**5,842**	5,654
Conversion of notes	**—**	2,113
Acquisitions	**—**	1,050
Key employees incentive plan	**195**	191
Employee stock options	**396**	57
Balance, end of year	**202,006**	195,573
Additional Capital:		
Balance, beginning of year	**223,499,143**	204,095,650
3% Stock dividend	**17,665,815**	13,847,283
Conversion of notes	**—**	2,687,887
Acquisitions	**—**	2,308,950
Key employees incentive plan	**470,797**	462,087
Employee stock options	**704,067**	97,286
Balance, end of year	**242,339,822**	223,499,143
Retained Earnings:		
Balance, beginning of year:		
As previously reported		100,169,252
Effect of retroactive change in accounting for leases (Note 2)		(14,309,532)
As restated	**106,257,781**	85,859,720
Net earnings for the year	**57,097,109**	45,317,241
Cash dividends	**(13,627,443)**	(10,960,976)
3% Stock dividend	**(17,671,657)**	(13,852,937)
Cash paid in lieu of fractional shares on stock dividend	**(130,199)**	(105,267)
Balance, end of year	**131,925,591**	106,257,781
Total Shareholders' Equity	**$374,467,419**	$329,952,497

See notes to consolidated financial statements.



CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

THE SOUTHLAND CORPORATION AND SUBSIDIARIES

	Year ended December 31 1978	1977
Sources of Working Capital:		
From operations:		
Net earnings	**$ 57,097,109**	$ 45,317,241
Expenses charged to earnings which did not require outlay of working capital:		
Depreciation and amortization	**46,839,875**	41,991,861
Amortization of capital leases	**20,884,330**	19,743,097
Deferred income taxes and other credits	**6,552,597**	3,415,874
Working capital provided from operations	**131,373,911**	110,468,073
Long-term debt	**70,658,506**	61,534,160
Capital lease obligations	**41,907,748**	37,409,857
Retirements and sales of property	**13,555,200**	12,774,857
Retirements and sales of capital leases	**1,397,049**	6,191,948
Issuance of common stock:		
Conversion of notes	**—**	2,690,000
Acquisitions	**—**	2,310,000
Key employees incentive plan	**470,992**	462,278
Employee stock options	**704,463**	97,343
	260,067,869	233,938,516
Uses of Working Capital:		
Property, plant, and equipment	**141,438,084**	96,324,184
Capital leases	**41,907,748**	37,409,857
Reduction of capital lease obligations	**23,112,351**	23,419,196
Payment of long-term debt	**4,718,034**	16,862,491
Cash dividends	**13,627,443**	10,960,976
Net noncurrent assets of businesses purchased for stock and cash	**29,180,394**	9,111,552
Retirement of long-term debt upon conversion of notes	**—**	2,690,000
Investments in affiliates	**647,216**	1,061,359
Other	**366,089**	836,640
Cash paid in lieu of fractional shares on stock dividend	**130,199**	105,267
	255,127,558	198,781,522
Increase in working capital	**$ 4,940,311**	$ 35,156,994
Changes in Working Capital:		
Increases in current assets:		
Cash and short-term investments	**$ 16,841,703**	$ 39,504,544
Accounts and notes receivable	**3,796,725**	7,788,618
Inventories	**34,341,389**	21,884,637
Deposits and prepaid expenses	**5,340,768**	1,482,830
Investment in properties	**2,537,927**	9,342,429
	62,858,512	80,003,058
Increases (decreases) in current liabilities:		
Accounts payable and accrued expenses	**43,026,457**	38,624,253
Income taxes	**3,155,570**	4,442,417
Long-term debt due within one year	**9,112,813**	(611,614)
Capital lease obligations due within one year	**2,623,361**	2,391,008
	57,918,201	44,846,064
Increase in working capital	**$ 4,940,311**	$ 35,156,994

See notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS YEARS ENDED DECEMBER 31, 1978 AND 1977

THE SOUTHLAND CORPORATION AND SUBSIDIARIES

1. Accounting Policies:

Principles of Consolidation

The financial statements include the accounts of domestic and Canadian subsidiaries, all of which are wholly-owned. Intercompany transactions are eliminated.

Investments in affiliates are accounted for by the equity method. Accordingly, such investments are shown at cost to the Company plus equity in undistributed earnings since acquisition. Equity in earnings is included in other income. Investments in affiliates consist primarily of amounts invested in a wholly-owned United Kingdom subsidiary engaged in the operation of retail stores. Earnings of this subsidiary are stated net of amortization of the intangibles which arose on the acquisition (straight-line over 40 years), foreign income taxes, and a provision for United States federal income taxes.

The classifications in use for the current year have been applied to the statements for 1977.

Revenues

Net sales are comprised of sales of products and merchandise (including sales by stores operated by franchisees) and other operating revenues which consist principally of truck rentals.

Sales by stores operated under domestic and foreign area license agreements are not included. All fees or royalties arising from such agreements are included in other income. Initial fees are recognized as the services required under the agreements are performed.

Inventories

Inventories are stated at the lower of cost (first-in, first-out method) or market, which, as to merchandise in stores, is determined by the retail inventory method.

Investment in Properties

Investment in properties includes land and buildings either to be sold for cash and leased back or to be mortgaged, as well as closed stores held for sale. The Company expects that cash will be realized for these properties within a twelve-month period. Working capital is used in the acquisition, construction, and carrying of these assets.

Depreciation and Amortization

Depreciation of plant and equipment and amortization of capital leases is based upon the estimated useful lives of these assets using the straight-line method. Amortization of improvements to leased properties is based upon the remaining terms of the leases or the estimated useful lives of such improvements, whichever is shorter.

Income Taxes and Investment Tax Credits

The tax effects of differences in timing between financial and tax reporting have been provided in the financial statements. The resulting deferred taxes arise principally from the use of accelerated depreciation methods for tax purposes and the capitalization of leases, as well as the provision for insurance claims for financial statement purposes.

Investment tax credits relating to leased and purchased equipment are deferred and taken into income ratably over either the terms of the leases or the useful lives of the assets.

Leases

Leases are classified as capital or operating in accordance with Statement of Financial Accounting Standards No. 13 (SFAS 13) as amended by subsequent interpretations. Capital leases are recorded at the lower of the discounted present value of future lease payments or the fair value of the property. Provision is made for the present value of estimated losses anticipated to be incurred due to the payment of rentals on closed stores, net of expected sublease rentals.

2. Lease Accounting Change:

The Securities and Exchange Commission mandated early application in 1978 of SFAS No. 13 which prescribes new accounting rules for leases. Accordingly, the financial statements for 1977 and prior years have been restated to comply with SFAS No. 13 including subsequent interpretations. The effect on the consolidated financial statements was as follows (000's omitted, except per share data):

			Net earnings		Retained earnings January 1,
	1977	1976	1975	1974	1974
As previously reported	$47,596	$40,277	$34,319	$29,736	$50,735
Effect of retroactive changes	2,279	2,428	2,251	2,569	7,062
As restated	45,317	37,849	32,068	27,167	43,673
Primary earnings per share	$2.26	$1.92	$1.63	$1.42	—

3. Acquisition of Chief Auto Parts:

On December 27, 1978, the Company acquired Chief Auto Parts (Chief), a chain of 119 retail auto parts stores in Southern California. The approximate cost of the net assets acquired, including expenses of acquisition, was $20,000,000, payable over a two-year period through January 2, 1981. The Company also obtained a five-year consultation and noncompetition agreement from the selling shareholder for $7,500,000 cash, which will be amortized over such period. The acquisition was accounted for by the purchase method and the excess of the cost over the fair value of the net assets acquired (which intangibles have been included in other assets at December 31, 1978) will be amortized on a straight-line basis over 40 years beginning in 1979. The results of operations of Chief will be included in the Company's consolidated financial statements beginning in 1979. If Chief had been combined on a pro forma basis with the Company's consolidated statements of earnings for the years ended December 31, 1978 and 1977, the effect on net sales and net earnings would not have been material.

4. Cash and Short-Term Investments:

Cash and short-term investments include certificates of deposit and U.S. Treasury Notes of $72,663,724 and $60,036,347 at December 31, 1978 and 1977, respectively. These short-term investments are stated at cost which approximates market.

5. Accounts and Notes Receivable:

	1978	1977
Trade	**$51,492,239**	$47,218,362
Franchisee	**30,243,800**	30,763,776
	81,736,039	77,982,138
Allowance for doubtful accounts	**(2,767,936)**	(2,810,760)
	$78,968,103	$75,171,378

6. Property, Plant, and Equipment:

Approximately 25% of the carrying amount of property, plant, and equipment is mortgaged. Mortgage lenders to certain wholly-owned real estate subsidiaries hold pledges of the shares of those subsidiaries as additional collateral.

	1978	1977
COST:		
Land	**$ 71,690,295**	$ 57,423,052
Buildings and leaseholds	**268,581,812**	214,631,768
Machinery and equipment	**282,740,267**	251,071,572
Vehicles	**57,434,478**	47,361,480
Construction in process	**15,338,026**	7,989,455
	695,784,878	578,477,327
Accumulated depreciation and amortization	**(216,230,514)**	(189,225,744)
	$479,554,364	$389,251,583

John and Jere Thompson present Jerry Lewis with $4.2 million raised for the Muscular Dystrophy Association.

The 1979 March of Dimes National Poster child represented the Dairies Group in the Rose Bowl Parade.

7. Long-Term Debt:

At December 31, 1978, long- term debt and amounts due within one year were as follows:

	Amount outstanding	Due within one year	Balance included in long-term debt
5%-9.86% Real estate and equipment notes (mature 1979 to 2007)	$121,297,215	$ 5,604,868	$115,692,347
5¾% Convertible subordinated notes due 1987	270,000	30,000	240,000
5% Convertible subordinated debentures due 1987	30,000,000	—	30,000,000
8⅜% Sinking fund debentures due 2002	50,000,000	—	50,000,000
9⅜% Sinking fund debentures due 2003	48,628,125	—	48,628,125
16% Note issued in Chief acquisition (payable 1979 to 1981)	19,500,000	2,600,000	16,900,000
13⅜% Notes assumed in Chief acquisition (payable in 1979)	5,020,000	5,020,000	—
	$274,715,340	$13,254,868	$261,460,472

The 5¾% convertible notes and the 5% convertible debentures may, at the option of the holders, be converted at any time prior to maturity into the Company's common stock. The present conversion ratios are 79.20 and 28.41 shares, respectively, for each $1,000 of principal. At December 31, 1978, there were 873,684 shares reserved for the conversion of these notes and debentures.

The 8⅜% debentures require annual sinking fund payments beginning February 15, 1983, in the amount of $2,500,000, which, at the option of the Company, may be increased to $5,000,000.

The 9⅜% debentures require annual sinking fund payments beginning December 15, 1984, in the amount of $2,500,000, which, at the option of the Company, may be increased to $5,000,000.

At December 31, 1978, the aggregate amounts of long-term debt maturities were as follows for the years ending December 31: 1979 — $13,255,000; 1980 — $10,801,000; 1981 — $14,035,000; 1982 — $4,123,000; 1983 — $4,395,000.

8. Deferred Credits:

Deferred credits include deferred investment tax credits of $15,664,697 and $12,523,694, and deferred federal income taxes of $5,762,608 and $4,460,524 at December 31, 1978 and 1977, respectively. As a result of the required retroactive application of SFAS 13, deferred federal income taxes were reduced by $16,183,000 at December 31, 1977. The net current asset portion of deferred income taxes of $5,984,342 and $4,252,284 at December 31, 1978 and 1977, respectively, has been included in deposits and prepaid expenses. Investment tax credits included in income amounted to $2,409,971 in 1978 and $2,136,119 in 1977.

9. Common Stock:

Under a terminated qualified stock option plan, 36,640 shares were issued during 1978 at prices ranging from $16.34 to $18.88 per share and all remaining options expired or were cancelled. During 1977, 5,876 shares were issued at prices ranging from $16.34 to $18.88 per share, and options for 41,760 shares expired or were cancelled.

At December 31, 1978, under a nonqualified stock option plan, options for 225,010 shares were outstanding at $20.26 and $24.03 per share, of which options for 39,185 shares were exercisable. During 1978, 4,100 shares were issued at $20.26 and $24.03 per share, and options on 5,305 shares were cancelled. During 1977, no options were exercised, and no options expired or were cancelled. An additional 301,322 shares are available for future grants under the plan. Options are granted at the fair market value of the shares on date of grant and are exercisable ratably over a ten-year period.

The proceeds from shares issued and any applicable tax benefits related to the nonqualified options are credited to common stock and additional capital. No charges or credits are made to income with regard to options granted under these plans.

At December 31, 1978, 58,095 shares were reserved for issuance pursuant to a key employees incentive plan, of which approximately 30,000 shares will be issued in 1979. For 1978, an estimated total award of $1,127,000 has been accrued. In 1978 and 1977, respectively, 20,109 and 20,224 shares were issued under the plan.

The above information has been adjusted for stock dividends.

10. Leases:

Certain of the property and equipment used in the Company's business is leased. Generally, real estate leases are for primary terms of from 15 to 20 years with options to renew for additional periods, and equipment leases are for terms of from 5 to 10 years. No restrictions are imposed by the leases which have a material effect on the Company's operations.

The composition of capital leases reflected as assets in the consolidated balance sheets is as follows:

	1978	1977
Buildings	**$240,863,258**	$210,306,335
Equipment	**98,523,728**	94,950,892
	339,386,986	305,257,227
Accumulated amortization	**(141,656,946)**	(127,066,556)
	$197,730,040	$178,190,671

Capital Lease Obligations

The present value of minimum lease payments for capital lease obligations of $231,499,291 at December 31, 1978, is reflected in the consolidated balance sheet as current and noncurrent capital lease obligations of $20,157,217 and $211,342,074, respectively, and represents the total minimum lease payments less estimated executory costs of $11,797,722 and an amount representing imputed interest of $151,719,435. Future minimum lease payments on these leases totaled $395,016,000 and are due in: 1979 — $38,835,000; 1980 — $36,973,000; 1981 — $33,788,000; 1982 — $30,942,000; 1983 — $27,608,000; and thereafter — $226,870,000.

During 1978, The Southland Corporation Employees' Savings and Profit Sharing Plan (Profit Sharing) purchased 118 7-Eleven stores from the Company for a total of $20,784,315, the Company's direct cost plus 15% which approximates expenses incurred. The stores were simultaneously leased to the Company at annual rentals approximating market rates. As of December 31, 1978, Profit Sharing owned a total of 1,052 stores which were leased to the Company under capital leases and which are reflected in buildings in the table above at a carrying amount of $71,000,000.

The amount representing imputed interest necessary to reduce net minimum lease payments to present value has been calculated generally at the Company's incremental borrowing rate at the inception of each lease. Noncancelable sublease rental income and contingent rental expense are not material and have not been reflected in total minimum lease payments.

Operating Leases

Future minimum lease payments required by operating leases at December 31, 1978, totaled $269,675,000 and are due in: 1979 — $26,335,000; 1980 — $24,514,000; 1981 — $22,501,000; 1982 — $20,767,000; 1983 — $19,259,000; and thereafter — $156,299,000. These lease payments have not been reduced by $21,040,000 of future rental income under noncancelable subleases.

Lease expense on operating leases in the years ended December 31, 1978 and 1977, totaled $42,236,000 and $39,222,000, respectively. Contingent rental expense is not material.

11. Income Taxes:

Provisions for income taxes are as follows:

	1978	1977
Federal:		
Current	**$44,564,000**	$36,634,400
Deferred	**5,121,000**	2,693,000
State	**5,926,000**	5,312,600
	$55,611,000	$44,640,000

12. Earnings Per Share:

Primary earnings per share are based upon the average number of shares outstanding during each year after giving effect to subsequent stock dividends.

Earnings per share assuming full dilution are based on (a) the number of shares used in computing primary earnings per share, (b) shares issuable upon conversion of convertible notes and debentures at the stated conversion rates (related interest requirements eliminated), (c) the number of shares issuable on the exercise of stock options after reduction for shares assumed to have been purchased with proceeds, and (d) average shares issuable under the key employees incentive plan.

13. Quarterly Financial Data (Unaudited):

The classification of items in determining gross profit conforms to that used in the consolidated statements of earnings. Summarized quarterly financial data is as follows (000's omitted, except per share data):

							Three Months Ended	
	March 31		June 30		September 30		December 31	
	1978	1977	**1978**	1977	**1978**	1977	**1978**	1977
Net sales	**$646,083**	$535,296	**$774,465**	$646,017	**$844,521**	$691,819	**$811,463**	$662,977
Gross profit	**155,737**	131,451	**199,293**	165,039	**211,336**	175,668	**199,142**	160,160
Net earnings	**7,061**	5,523	**18,238**	14,538	**19,114**	15,525	**12,684**	9,731
Earnings per share:								
Primary	**$.35**	$.28	**$.90**	$.73	**$.95**	$.77	**$.63**	$.48
Fully diluted	**.35**	.27	**.87**	.70	**.91**	.75	**.61**	.47

The gross profit and net earnings of the quarterly periods have been restated to reflect the retroactive application of SFAS 13. The effect was not material.

14. Replacement Cost Information (Unaudited):

Replacement cost information will appear in the notes to consolidated financial statements in the Form 10-K to be filed with the Securities and Exchange Commission.

The unit cost of merchandise purchased for sale increased slightly during 1978. No significant impact on earnings arises from these increases because the average holding period for such merchandise is relatively short and the Company has the ability to react quickly to cost changes and make appropriate adjustments to selling prices.

15. Segment Information:

The Stores Group includes all convenience and grocery stores in the United States and Canada, as well as those activities (such as self-serve gasoline, distribution, and food preparation) which derive the majority of revenues and operating profits from support of these stores. The Dairies Group includes milk and ice cream processing and distribution, salad-making, and packaging. The Special Operations Group includes the ice, chemical, truck leasing, and retail auto parts divisions. The revenues and operating profits of the retail auto parts division (see Note 3) are not included in the segment information shown in the table. Corporate items reflect income, expenses, and assets not allocable to segments.

Intersegment sales are accounted for on a cost plus markup basis. Expenses directly identifiable with a segment and certain allocated expenses are used to determine operating profit by segment.

(000's Omitted)	**1978**	1977
Revenues:		
Stores Group	**$2,791,035**	$2,271,924
Dairies Group	**388,956**	362,292
Special Operations Group	**56,161**	48,169
Corporate	**4,801**	3,317
	3,240,953	2,685,702
Intersegment revenues:		
Dairies Group	**(135,563)**	(125,760)
Special Operations Group	**(15,296)**	(14,527)
Consolidated revenues	**$3,090,094**	$2,545,415
Operating profits:		
Stores Group	**$ 142,682**	$ 115,750
Dairies Group	**6,650**	6,016
Special Operations Group	**6,037**	6,667
Consolidated operating profits	**155,369**	128,433
Interest expense	**(35,129)**	(31,604)
Corporate expense — net	**(7,532)**	(6,872)
Consolidated earnings before income taxes	**$ 112,708**	$ 89,957
Identifiable assets (including capital leases):		
Stores Group	**$ 863,228**	$ 721,968
Dairies Group	**100,265**	95,220
Special Operations Group	**80,206**	43,420
Corporate	**90,777**	81,923
Total identifiable assets	**$1,134,476**	$ 942,531
Capital expenditures (excluding capital leases):		
Stores Group	**$ 110,508**	$ 75,361
Dairies Group	**9,710**	9,327
Special Operations Group	**23,054**	18,701
Corporate	**9,116**	2,660
	$ 152,388	$ 106,049
Depreciation and amortization expense:		
Stores Group	**$ 51,934**	$ 48,395
Dairies Group	**5,496**	5,598
Special Operations Group	**7,551**	5,324
Corporate	**2,743**	2,418
	$ 67,724	$ 61,735

TOUCHE ROSS & CO.

2001 BRYAN TOWER, SUITE 2400
DALLAS, TEXAS 75201

Board of Directors and Shareholders
The Southland Corporation
Dallas, Texas

We have examined the consolidated balance sheets of The Southland Corporation and subsidiaries as of December 31, 1978 and 1977, and the related consolidated statements of earnings, shareholders' equity, and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

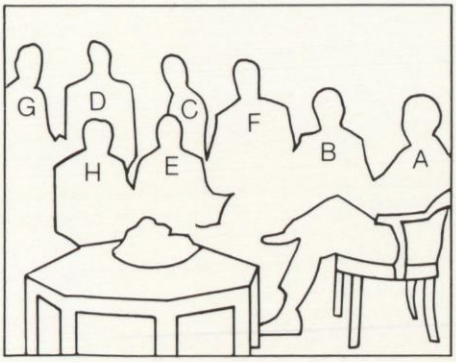
In our opinion, the consolidated financial statements referred to above present fairly the financial position of The Southland Corporation and subsidiaries at December 31, 1978 and 1977, and the results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis after restatement for the change, with which we concur, in the method of accounting for leases to comply with the provisions of Statement of Financial Accounting Standards No. 13 (see note 2 to the consolidated financial statements) which was applied early in accordance with the requirements of the Securities and Exchange Commission.

Touche Ross & Co.

Certified Public Accountants

Dallas, Texas
February 12, 1979

BOARD OF DIRECTORS



A **JOHN P. THOMPSON** (1948)
Chairman of the Board and
Chief Executive Officer

B **JERE W. THOMPSON** (1961)
President

C *WILLIAM W. ATWELL (1976)
President
Atwell Construction Co., Inc.

D *J. Y. BALLARD (1937)
Consulting Engineer

E **WALTON GRAYSON, III** (1962)
Executive Vice President

F **JOSEPH S. HARDIN** (1977)
Executive Vice President

G *MARK L. LEMMON, M.D. (1977)
Plastic and Reconstructive Surgeon

H **CLIFFORD W. WHEELER** (1960)
Vice President

(Date indicates year elected)
*Members of Audit Committee

OFFICERS

JOHN P. THOMPSON 53
Chairman of the Board and
Chief Executive Officer

JERE W. THOMPSON 46
President

WALTON GRAYSON, III 50
Executive Vice President,
Administration and Services

JOSEPH S. HARDIN 63
Executive Vice President,
Planning and Special Operations

RAY D. BERRY 38
Vice President, Stores Group

M. T. COCHRAN, JR. 60
Vice President, Dairies Group

S. R. DOLE 41
Vice President, Stores Group

VAUGHN R. HEADY 58
Vice President

CLARK J. MATTHEWS, II 42
Vice President and General Counsel

W. K. RUPPENKAMP 59
Vice President, Financial Relations

FORREST STOUT 60
Vice President

J. C. THOMPSON, JR. 38
Vice President

CLIFFORD W. WHEELER 64
Vice President

R G SMITH 55
Secretary and Treasurer

P. EUGENE PENDER 47
Controller

SHAREHOLDERS INFORMATION

SECURITIES LISTED:
COMMON STOCK
8⅜% SINKING FUND DEBENTURES
9⅜% SINKING FUND DEBENTURES
New York Stock Exchange
5% CONVERTIBLE SUBORDINATED DEBENTURES
Luxembourg Stock Exchange

TRANSFER AGENT AND REGISTRAR:
COMMON STOCK
First National Bank in Dallas
8⅜% SINKING FUND DEBENTURES
Mercantile National Bank at Dallas
9⅜% SINKING FUND DEBENTURES
First International
Bank in Houston, N.A.

AUDITORS:
Touche Ross & Co.
Dallas, Texas

ANNUAL MEETING:
The Annual Meeting of the Company will be held at 10 a.m. Wednesday, April 25, 1979, in the North Wing Auditorium of the Corporate Office, 2828 North Haskell Avenue, Dallas, Texas. All shareholders are cordially invited to attend.

FORM 10-K:
Shareholders may obtain a copy, exclusive of exhibits, of the Form 10-K Annual Report for the year ended December 31, 1978, as filed with the Securities and Exchange Commission, by writing to the Financial Relations Department at the Company's mailing address.

AUTOMATIC STOCK PURCHASE PLAN:
This plan provides a simple, convenient, and inexpensive way for shareholders to invest cash dividends and voluntary cash deposits in additional Southland shares. For further information, write the Financial Relations Department at the Company's mailing address.

MAILING ADDRESS:
P.O. Box 719, Dallas, Texas 75221

TELEPHONE:
(214) 828-7011

THE SOUTHLAND CORPORATION 1978 ANNUAL REPORT
2828 NORTH HASKELL · DALLAS, TEXAS 75204